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In The

Supreme Court of the United States

October Term, 1998

MICHIGAN AUTOMOTIVE RESEARCH CORPORATION

Petitioner

On Petition for a Writ of Certiorari from the Michigan Court of Appeals

PETITION FOR WRIT OF CERTIORARI

MILLER, CANFIELD,
PADDOCK AND STONE
Robert F. Rhoades, Esquire
Counsel of Record
150 West Jefferson,
Suite 2500
Detroit, Michigan 48226
(313) 963-6420
Attorney for Petitioner

65pp

QUESTIONS PRESENTED FOR REVIEW

I. Does The Industrial Processing Exemption, Provided In The Michigan Use Tax Act As Administered By The State Department Of Treasury, Deny Petitioner **Equal Protection** Of The Law, By Denying Exemption To Petitioner While Granting Exemption To Others Similarly Situated?

II. Did The Michigan Court Of Appeals Violate MARCO's Right To Substantive Or Procedural **Due Process** Of Law, By Retroactively And *Sua Sponte* Applying A 1987 Statutory Amendment To Resolve The Meaning Of A 1970 Amendment, When The 1970 Statute Was Clear And When MARCO Had Relied On The 1970 Statute And The Cases Concerning The Exemption In Its Contractual Arrangements?

PARTIES TO THE PROCEEDING

Michigan Automotive Research Corporation,
By Robert F. Rhoades of MILLER, CANFIELD,
PADDOCK AND STONE, P.L.C.
150 West Jefferson, Suite 2500
Detroit, Michigan 48226
(313) 963-6420
FAX: (313) 496-7500
www.millercanfield.com

Michigan Department of Treasury
Frank J. Kelly
Attorney General
Thomas L. Casey
Counsel of Record
Michael R. Bell
Assistant Attorney General
Revenue Division
First Floor Treasury Building
Lansing, Michigan 48922

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I. CITATION TO OPINIONS AND ORDERS

The August 28, 1998, Order of the Michigan Supreme Court regarding *Michigan Automotive Research Corporation v Michigan Department of Treasury*, 581 N.W. 2d 132 (1998). App. to Pet. for Cert. 1a.[1]

The May 5, 1998, Order of the Michigan Supreme Court regarding *Michigan Automotive Research Corporation v Michigan Department of Treasury*, 581 N.W. 2d 132 (1998). App. to Pet. for Cert. 2a.

The Court of Appeals for the State of Michigan May 9, 1997, Order is included in App. to Pet. for Cert. 3a.

The Court of Appeals for the State of Michigan decision is reported at *Michigan Automotive Research Corporation v Michigan Department of Treasury*, 222 Mich. 227, 564 N.W. 2d 503 (1997). App. to Pet. for Cert. 4a.

The Michigan Supreme Court Order entered on November 1, 1994, remanding to apply Judge White's dissent, is reported at *Michigan Automotive Research Corporation v Michigan Department of Treasury*, 447 Mich. 1005, 526 N.W. 2d 914 (1994). App. to Pet. for Cert. 9a.

The State of Michigan Court of Appeals, February 1994, decision is included at App. to Pet. for Cert. 10a-13a.

The State of Michigan Tax Tribunal January 15, 1991, Order is included at App. to Pet. for Cert. 14a.

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[1] All App. to Pet. for Cert. __a, references are to the attached Appendix to the Petition for Writ of Certiorari.

The State of Michigan Tax Tribunal October 30, 1990, Opinion is included at App. to Pet. for Cert. 15a.

II. Basis for Supreme Court Jurisdiction

The judgment of the Michigan Supreme Court was entered on August 28, 1998. App. to Pet. for Cert. 1a.

This Court has jurisdiction to review the judgment in question on a writ of certiorari pursuant to 28 U.S.C. § 1254.

III. Michigan Statutes Involved in the Case

The industrial processing exemption of the Michigan Use Tax and specifically the 1970 and 1987 Amendments of that statute being 1970 P.A. 15 and 1987 P.A. 141.

IV. Statement of the Case

This matter involves the assessment of use tax by the State of Michigan, Department of Treasury,[2] on materials purchased by Michigan Automotive Research Corporation[3] for use in dynamometer engine testing which MARCO performed on engines owned by Automobile Manufacturers, for the period March 1, 1981 through December 31, 1983. MARCO maintained that it was entitled to the use tax industrial processing exemption.

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[2] The State of Michigan Department of Treasury will be hereinafter referred to as "Department."

[3] Michigan Automotive Research Corporation will be hereinafter referred to as "MARCO."

Michigan's use tax has contained an industrial processing exemption since its inception in 1937 (1937 P.A. 94). This case arose out of Michigan's interpretation of the state's industrial processing exemption as amended in 1970 by 1970 P.A. 15.

Prior to the 1970 Amendment (1970 P.A. 15), §4g of the Use Tax Act (MCLA 205.94(g); MSA 7.555(4)(g)) exempted property sold to persons for use or consumption in "industrial processing." From 1949 until the 1970 Amendment, that section read:

> "(g) *Property sold to persons for use or consumption in industrial processing*: Provided, that the term 'industrial processing' shall not be deemed to include tangible personal property permanently affixed and becoming a structural part of real estate."

The statute contained no definition of industrial processing. The Department, in its promulgated Rule 40 (AC R 205.90) concerning industrial processing, however, had long interpreted "industrial processing" as follows:

> (2) "Industrial processing" means the activity of converting or conditioning tangible personal property by *changing the form, composition*, quality, combination *or character of the property for ultimate sale at retail* or use in manufacturing of a product to be ultimately sold at retail. Rule 40(2); AC R 205.90(2)

The same Rule *also* recognized that "industrial processing" included "experimental, development engineering inspection, and quality control" activities as well as what could be thought of as the actual production process itself:

(5) Industrial processing includes the following activities:

(a) Production.

(b) Patent, *experimental, development, engineering inspection and quality control.*

(c) Planning, scheduling and production control.

(d) Design, construction and maintenance of factory machinery, equipment and tooling.

(e) Disposal of production scrap and waste.

(f) Production supervision.

(g) Production material handling.

Rule 40(5); AC R205.90(5) (*emphasis added*). Thus, the Department had long considered development, engineering inspection and quality control activities to be a part of the "changing" of the "form, composition, quality, combination or character" of property to be sold at retail. Thus, when an automobile manufacturer such as GM, Ford or Chrysler owns and operates a dynamometer testing lab, those activities have long been recognized as altering the "form, composition or character" of the engines ultimately sold at retail.[4]

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[4]The Department even after the 1970 Amendment still recognizes that testing identical to MARCO's testing is industrial processing when conducted by companies such as Ford, Chrysler and GM. See Stipulation ¶14.

There was nothing in the Act before 1970 even arguably requiring that such experimental, development or engineering inspection type work be done by the same entity which later sold property at retail. A line of cases developed which recognized that the industrial processing necessary to make a product often involves several companies each of which (not just the one which sells the product) was entitled to the exemption.[5] Thus, the testing of drugs by an independent out-sourced testing lab was viewed as industrial processing even though the drugs being tested would be made and sold by others.[6] MARCO's activities were without question "industrial processing" before consideration of the exception to the exemption enacted in 1970.

The 1970 Amendment added an exception to the exemption underlined below:

> "(g) Property sold to persons for use or consumption in industrial processing. 'Industrial processing' shall not include tangible personal property permanently affixed and becoming a structural part of real estate; *services performed upon property owned by*

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[5] *Minnuet v Department of Revenue*, 366 Mich. 117; 113 NW2d 868 (1962); *International Research and Development Corp. v Department of Revenue*, 25 Mich. App. 8; 181 N.W. 2d 53 (1970); *Aero-Detroit, Inc. v Department of Treasury*, Michigan Board of Tax Appeals Docket No. 1295, CCH Michigan Tax Reporter ¶ 200-753, at 338, 9/21/78; *Liquid Disposal, Inc. v Department of Treasury*, State Board of Tax Appeal Docket No. 1648, CCH Michigan Tax Reporter ¶ 200-907, 461, 8/7/81; *M.E. Trucking Company v Department of Treasury*, MTT Docket No. 73927, rel'd 10/9/85; and *Chem-Met Services v Department of Treasury*, MTT Docket No. 84112, CCH Michigan Tax Reporter ¶ 201-249, at 935, 6/30/86.

[6] See *International Research and Development Corp v Department of Revenue*, 25 Mich. App. 8, 181 N.W. 2d 53 (1970).

> *others where the services do not transform, alter or modify the property so as to place it in a different form, composition or character*; office furniture, office supplies and administrative office equipment; receiving and storage of raw material purchased or extracted by the user or consumer; vehicles licensed and titled for use on public highways; the preparation of food and beverages by a retailer for retail sale. (*emphasis added*) (MCLA 205.94 (g); MSA 2.555(4)(g))

A literal reading of the exception to the exemption added in 1970 provides that activities which otherwise would qualify as industrial processing (activities already viewed as altering the form, composition quality, combination or character of property sold at retail) are now to be excluded from industrial processing if the activities are "services performed on the property owned by others where the services do not transform, alter or modify the property so as to place it in a different form, composition or character."

Applying the language of the 1970 amendment, MARCO would be exempt from the tax by virtue of the pre-1970 language, but then excepted from exemption by virtue of the 1970 language (because it does perform services on the property (engines) owned by others) *unless* MARCO "alters" the "form, composition or character" of the engines it tests. Applying the statute literally, if MARCO alters the form or character of the engines it tests, the exception to the exemption does not apply, and MARCO remains exempt from the tax at issue.

The statute was amended again in 1987 (1987 P.A. 114) which was 4 years after the last tax year at issue in this case and neither party asserted that the 1987 Amendment applied to this case.

Following an informal departmental conference concerning the 1981-1983 assessment, the Department's Hearing Referee issued a recommendation on September 24, 1985, concluding that MARCO qualified for the industrial processing exemption and that the proposed assessment in question was improper. (Stipulation ¶ 7). The Department disagreed with its own hearing officer and issued final assessment C566061. (Stipulation ¶ 9).

MARCO then appealed to the Tax Tribunal (MTT Docket No. 109067.) Before the hearing, the parties entered a stipulation, App. to Pet. for Cert. 16a-18a

That 1990 stipulation provides *inter alia*:

> "12. Materials, supplies, and equipment purchased by auto manufacturers for use in testing procedures have been uniformly granted exemption pursuant to the industrial processing exemption by the Department.
>
> 13. Automobile manufacturers are MARCO's principal customers.
>
> 14. Automobile manufacturers engage in testing activities substantially identical to those performed by MARCO and are uniformly granted the benefit of the industrial processing exemption with respect to those testing activities by the Department."

The parties stipulated that if MARCO is determined to be entitled to the industrial processing exemption in connection with the testing activities, the entire assessment herein shall be canceled. (Stipulation ¶ 11).

The additional proofs were taken at a hearing before a Michigan Tax Tribunal Hearing Officer on July 5, 1990. A Proposed Opinion and Judgment was entered on October 30, 1990, which was adopted as the Opinion and Judgment of the Tax Tribunal on January 11, 1991. MARCO's arguments were based on its interpretation of the statutory exemption and the claim that denial would deny it equal protection. The Tribunal ruled that MARCO qualified for the industrial processing exemption and canceled the assessment of use tax at issue. It further ruled that a contrary result would deny MARCO equal protection. The Tax Tribunal's legal analyses relied on then existing case law which had been based on the pre-1970 amendment and a non-literal interpretation of the 1970 Amendment, which harmonized the amendment with the earlier case law.

The Department of Treasury appealed to the State Court of Appeals. While that appeal was pending, the Court of Appeals decided in *Beckman Production Services v Department of Treasury*, 202 Mich. App. 342; 508 N.W. 2d 178 (1993). In the *Beckman* case, the Court held that 1970 P.A. 15 created an exception to the exemption, which must be applied literally.

The first Court of Appeals' decision in this case (Court of Appeals No. 137368), applied the *Beckman* holding and found that the "property" referenced in the 1970 Amendment which had to be altered was, as applied to this case, were the engines MARCO tested, not the property ultimately sold, at retail. The Court held that the 1970 Amendment, created a new requirement by which MARCO must after 1970 alter the form, composition or character of the engines it tested in order to qualify for exemption.

The Court of Appeals' panel split as to whether MARCO met that test. The majority opinion in the first Court of Appeals decision found that MARCO altered the engines it tested by wear and tear. The majority opinion

referenced only wear and tear type alterations and ignored other non-wear and tear type changes, which were described in the record. More importantly, the majority ignored MARCO's contention that the carefully applied wear caused a change of "character" from a source of power to a study specimen. It ignored the facts found by the Tribunal concerning the changes to the engines tested. The majority stated without explanation that wear and tear was not the type of alteration intended by the legislature.

The Court of Appeals' dissent by Judge Helene White would have remanded because there was evidence in the record from which one could have found that the engines tested "were altered to the extent their "form" and "character" had "changed"." Judge Helene White's dissent would require MARCO to be granted the tax exemption at issue if that fact (alteration of form or character) were established. Her analysis required nothing more than that. Noting that the Tribunal had approached its analysis applying a different test, the dissent would have remanded to let the Tribunal apply the statutory exception to the facts. MARCO timely filed a Motion for Rehearing in the Court of Appeals which was denied on April 13, 1994.

MARCO then sought leave to appeal to the Michigan Supreme Court. The Michigan Supreme Court, in lieu of granting leave to appeal, *modified the Court of Appeals decision by remanding.* (See App. to Pet. for Cert. 9a). Had that order been obeyed on remand, MARCO would have prevailed because MARCO clearly alters the form and character of the engines it tests.

On remand, the parties stipulated to additional facts, (App. to Pet. for Cert. 15a), and submitted briefs on the issue on remand. The Michigan Tax Tribunal, on remand from the Michigan Supreme Court, did not limit itself to the issue of whether MARCO altered the "form, composition or

character" of the engines it tested. It ruled against MARCO *because the engines MARCO tests are not also ultimately sold at retail.*

MARCO appealed to the State Court of Appeals asserting *inter alia* that the Michigan State Supreme Court remand order had been violated, because the Michigan Tribunal had added to the tests adopted in the remand order, an additional test as the reason for denying exemption.

A different three-judge panel heard the second MARCO appeal to the Court of Appeals. It affirmed the Michigan Tax Tribunal's decision, reasoning *sua sponte* that because the 1970 Amendment and 1987 Amendment were similar in language (an incorrect conclusion) and because, pursuant to the 1987 language MARCO would not qualify for exemption (an issue not presented to that Court as it was irrelevant) that it would interpret the 1970 Amendment to reach the same result that would be reached had the 1987 amendment been applied.

Concerning MARCO's claim that the Michigan Tax Tribunal had defied the remand instructions by applying a test in addition to the test applied in the earlier dissent which had been adopted in the Supreme Court's remand order, the Court of Appeals reasoned that because the dissent had concluded that Judge White would remand for application of the correct test, and because the test (including the new test) was, in the second panel's view, the correct test, the decision was, in the second panel's view, in accord with the remand instructions. (This of course ignores the dissent's explanation of what the "correct test" was, which preceded the admonition to apply the correct test).

MARCO then applied for leave to appeal to the Michigan Supreme Court raising *inter alia* the equal protection issue which had been rejected in the first Court of Appeals decision, and the new issue arising for the first time out of the

new positions of the Court of Appeals which were that the decision denied it both substantive and procedural due process of law.

The Michigan Supreme Court denied leave to appeal and it denied rehearing.

Concerning the substance of how MARCO operates, MARCO is engaged in performing contract engine and powertrain testing. (TR 15). The same types of tests performed by MARCO are also performed in-house by the auto companies. (TR 21) The in-house laboratories of the auto companies submit bids for the same testing work for which MARCO bids. (TR 17) Such testing is regarded as necessary to the production of an engine, and all of the auto companies perform substantial amounts of testing on engines. (TR 22). Without such testing, failures of engines could occur which "could be dangerous if they happened in the hands of the customer or happened under the wrong circumstances." (TR 18). In performing its testing activities, MARCO attends capacity planning meetings and other meetings at its customers' facilities regularly. (TR 23-24). MARCO's witness testified:

> "We function and we strive for a relationship with our customers where we are considered the same as part of their in-house team of testing experts." (TR 23).

In describing the relationship with MARCO's customers, its witness testified that in routinely attending capacity planning meetings, MARCO discusses the testing needs of its customers during the upcoming quarter, and MARCO's customers:

> ". . . treat our facilities the same as they treat their in-house facilities. We're part of one big

> testing capacity that our customers can load their testing requirements against. So they treat the testing capacity that we have the same as they treat their own internal testing capacity, and they load against our capacity the same as they would load against their own."(TR 24).

MARCO's test results are treated exactly the same way as internally obtained test results of its customers. (TR 24). The identical tests are run, using the customers' published confidential test procedures. Test data is collected and published the same way as MARCO's customers publish and present it internally. (TR 25).

In providing testing to its customers, MARCO routinely provides capacity commitments of a specified number of "test stands" or "test cells" for a specified period of time. (TR 25). In one case, during the late 1970's, MARCO built six additional test stands as a direct result of a long-term contract with Ford Motor Company to provide that capacity. (TR 25-26).

MARCO's witness testified that MARCO organizes its work flow in such a way that a testing engineer dedicated to a particular customer will not be dealing with any other customer which could create a conflict, to assure the customer that the data is kept in a confidential matter. (TR 55). MARCO has had its activities audited by its customers, and its customers require MARCO's employees to sign confidentiality statements identical to the ones that their own internal employees sign, to assure that MARCO provides them with the same level of security of data that they would have in their own internal operations. (TR 56).

In summarizing MARCO's working relationship with its customers, its witness testified:

> "A: We are an integral part of the testing process of our customers. We function as a team with our customers." (TR 23).

MARCO's tests are conducted in test cells which are concrete block rooms, 20 feet by 22 feet in size and 14 feet high. (TR 28). The cells are controlled by computer-based control and data acquisition systems from a control room immediately adjacent to the test cell. (TR 29). There are modifications made to the test cells and each test site for each particular engine tested. Typical modifications include motor mounts, wiring systems, and cooling systems. (TR 29).

As a result of the conduct of the tests, the engines, which are tested, undergo significant changes. (TR 31). Because the purpose of the test is to operate the engines and to monitor wear or determine failures (TR 18, 63), the engines always enter MARCO's facility new and leave the facility worn and sometimes disassembled. (TR 31). The engines are so altered that they could not be installed in a car to be sold after undergoing MARCO's testing procedures. (TR 14).

MARCO's witness testified that the engines which are tested, are changed as a result of the wear and tear which has occurred. (TR 64). He testified that such wear and tear on the engine parts represents a significant change, stating: that "... the wear and tear is significant. That is the whole purpose for doing the test is to determine what has worn." (TR 63). Thus, while in one sense the tested engines are changed as to preclude their use as sources of power, in another important sense the engines are transformed from sources of power, to study specimens as a result of the changes which occur during the testing protocol. (See Second Stipulation, ¶1c quoted below in which the parties agree that the use to which the engines can be put changes from a source of power for vehicles, to a study specimen. The tested engines are altered

as a result of "carefully controlled, monitored and recorded" forces placed on them during the testing protocol. (See Stipulation ¶1a.) Only as a result of those changes, which occur during testing, can those engines then be studied to determine how the controlled and monitored forces applied during the test affect the engines.

At the conclusion of the tests conducted by MARCO, it returns the tested engine to the customer, along with a report of the test results. (TR 47).

The First Court of Appeals' majority and dissenting opinions both found that the use tax exemption for industrial processing at issue either applied or not depending on whether MARCO "altered" the engines it tested as to change the "form, composition or character" of those engines. Both opinions also agreed that there had been an "alteration" of the tested engines, so the exemption in this case turned on whether those alterations were of "form, composition, or character". See App. to Pet. for Cert. 4a. The Michigan Supreme Court's remand order, by adopting the Court of Appeals' dissent, required findings of fact as to permit application of the statutory test, which was whether the engines tested were altered as to "form, composition or character".

On this point, the parties submitted a second stipulation, which provided:

> "1. The Tax Tribunal has requested stipulation of additional facts which may alleviate the need for an evidentiary hearing. The parties agree that the following facts from the record may be deemed admitted:
>
> a. The engines (and occasionally, other parts, referred to collectively as

"engines") tested are monitored and the forces placed upon those engines are carefully controlled, monitored and recorded during the test.

b. Testing and monitoring equipment is attached to the engines before the tests begin. During the test, the engines sustain measurable wear on the engine parts (which wear is measured and studied after the test) and by evidence of engineering failure, which causes some engines to disintegrate. (The testing is done in concrete test cells with the testing personnel located safely outside the cell because some engines disintegrate during tests.) As a part of the testing procedures, engines are disassembled and dimensionally mapped, which is the measuring of the parts of the engine tested to compare the dimensions, sizes and shapes before and after the application of forces applied in the tests.

c. The use to which the engines tested can be put changes as a result of the tests. Such engines are no longer suitable for use in vehicles, but they are usable and used to study the changes, which took place as a result of the forces applied during the testing.

2. This stipulation does not limit the record and the parties may argue based on this stipulation

as well as the rest of the record. App. to Pet. for Cert. 10a.

The Michigan Tax Tribunal received briefs and then issued its opinion. App. to Pet. for Cert. 14a.

V. ARGUMENTS IN SUPPORT OF PETITION

A. THE DISPARATE TREATMENT OF MARCO AND ITS COMPETITORS VIOLATES MARCO'S RIGHT TO EQUAL PROTECTION OF THE LAW.

MARCO raised this issue in its first appeal to the Michigan Tax Tribunal. The Tribunal in its first decision found merit in the argument but did not have to address it because it held MARCO exempt. MARCO raised this issue in the first Court of Appeals case and in its 05/03/94 application for leave to appeal from the First Court of Appeals' decision. If leave had been denied, as to let stand the ruling that MARCO was taxable, it would have pursued federal remedies at that time. However, the Michigan Supreme Court properly remanded the case solely for further proceedings limited to the factual determination of whether MARCO really altered the form or character of the engines it tested. The equal protection issue was therefore not before the Tribunal or Court of Appeals on remand. When the case was again brought before the Michigan Supreme Court on application for leave to appeal, the equal protection issue was again raised and briefed.

The Department has admitted that during the years at issue, it treated MARCO differently than it treated "in house" testing labs of Auto Companies. (Stipulation ¶¶ 12, 13 and 14, *see supra* p. 5 & 6) quoted in the Statement of Facts above)

The testing functions served by MARCO's testing activities and the testing activities undertaken in-house by the

Auto Companies are identical to the goal of producing a vehicle. GM, Ford and Chrysler all have dynamometer testing facilities, which bid against MARCO for work. MARCO acts as an extension of those labs when it does testing for those companies.

If, as the Court of Appeals has now ruled, MARCO is taxable for the 1981-83 years at issue when all the in-house testing labs have been treated as exempt, then for purposes of an equal protection analysis, one must consider whether such a classification is rationally related to a legitimate governmental interest or to the purpose of the legislation.

The classification does not promote the purpose of the legislation. The use tax is complementary to the sales tax. The sales tax is imposed on sales in the state. The use tax is imposed on the use of property in the state, which is not subjected to sales tax. The purpose of the industrial processing exemptions within the Sales and Use Tax Acts is to avoid "pyramiding" of the sales and use taxes *Elias Brothers Restaurants Inc. v Department of Treasury*, 452 Mich. 144, 152; 549 N.W. 2d 837 (1996). When pyramiding occurs, the final product sold to the public will bear a tax cost of greater than 4% (now 6%) of the product's price because the inputs will have been previously taxed once during production and again when the product is ultimately sold at retail. (See *Elias Brothers supra* 152.) The cost of fuel and supplies used by Auto Companies for testing has not been taxed in the 1970-1987 period. (See First Stipulation ¶14). There is no rational relationship related to the legislative objective of prevention of pyramiding, between taxing MARCO but not the auto companies on fuel used in testing engines, *because the testing in both instances serves exactly the same function in the making of a vehicle and the costs of either in-house or out-sourced testing will be passed along in the cost and price of the vehicles eventually sold.* Thus, the classification cannot promote the purpose of the legislation.

Concerning other potentially legitimate governmental purposes, which could be served by this classification, the State has asserted before the State courts that the classification is "an encouragement to manufacturing".[7]

Before addressing whether the encouragement of manufacturing is legitimate or related to the classification, one must consider whether such an asserted purpose for the classification is precluded by the Michigan Supreme Court's statements that the purpose of the legislation is to prevent pyramiding of the sales and use taxes.

In *Nordlinger v Hahn*, 505 U.S. 1, 15; 120 L. Ed. 2d 1, 112 S. Ct. 2326 (1992), this Court, while upholding the validity of a state tax classification, distinguished its earlier decision in *Allegheny-Pittsburgh Coal Co v County Comm'n of Webster County West Virginia*, 488 U.S. 336; 102 L. Ed. 2d 688; 109 S Ct 633 (1989), which had held a very similar classification invalid. The difference was in the purposes which were considered as potentially justifying the classification. In *Nordlinger*, the State asserted purposes, which the majority found sufficient. The *Allegheny-Pittsburgh* case, by contrast, had presented: "the rare case where the facts precluded any plausible inference that the reason for the unequal assessment practice was to achieve the benefits of an acquisition value system". (505 U.S. at 15)

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[7] See Response to MARCO's Application for Leave to Appeal, pp. 28-30. The State also argued briefly that generation of revenue is a legitimate governmental purpose, and indeed that is true, but as revenue can be raised without treating in-house and out-sourced testing differently that purpose cannot support the classification at issue. That classification is not rationally related to that classification. If the purpose of raising revenue could support any classification then the rational basis test would never apply to limit the power to create classes in state tax law.

In the present case, the legislative purpose behind Michigan's industrial processing exemption is not and never has been to promote manufacturing. This exemption is not a tax incentive, but a necessary structural component of a sales and use tax system intended to tax consumption. This is why the Michigan Supreme Court has specifically referred to the purpose of the industrial processing exemption as the prevention of pyramiding in *Elias Brothers, supra.*

If the assertion of a manufacturing incentive purpose is to be considered, as the purpose of the exemption, the classification still fails because manufacturing consists of those *activities* which cause a product to be made. Engine testing is equally manufacturing in nature whether it is performed in-house or out-sourced. The engines tested serve the same role in the production whether the tests are performed in-house or out-sourced. The engines tested could never be sold whether the test is performed in-house or out-sourced. The tests in all ways serve the same function in the making of a product whether performed in-house or out-sourced. The classification created by the state Court of Appeals, either taxes or exempts from taxation, testing activity depending upon whether the entity doing the testing also sells a product. What that promotes is *vertical integration, not manufacturing.* Modern manufacturing increasingly relies upon outsource suppliers to work with others as a team to manufacture products, just as MARCO works as a team with its customers to help make cars by testing engines. Thus, some work once done in-house is sometimes out-sourced, when it is efficient to do so. By creating an extra tax penalty on the potentially more efficient means of production, the classification promotes vertical integration at the expense of efficiency in manufacturing. That in turn cannot logically be viewed as incentive to manufacturing in the state, because manufacturers will want to locate where they can produce most efficiently.

The other necessary consequences of the classification created by the Michigan Court of Appeals is that smaller outsource supplier companies are placed at a tax cost disadvantage to larger companies in competing for the same work. Yet another necessary result of the classification is the limiting of competition for the same work. If the same work can be done in-house, or by any of several out-source suppliers, the present classification will discourage the existence of the outsource suppliers. These are the logical results of the classification.

The state has not asserted that the promotion of vertical integration on the discrimination against smaller companies as to promote less competition for portions of production is a legitimate state interest, but that is the only purpose actually served by the classification. We are aware of no authority or sound argument for the proposition that the discouragement of competition and encouragement of vertical integration are legitimate purposes of state government.

The only case cited below to support the classification was *American Sugar Refining v Louisiana*, 179 U.S. 89; 45 L. Ed. 2d 102; 21 S. Ct. 43 (1900). That turn-of-the-century decision did not apply contemporary equal protection analysis. It did not look to whether a legitimate governmental interest was furthered or whether the classification was reasonably related to such a purpose. The classification at issue in that case concerned agriculture. Mass production of automobiles in this country had not begun when the case was decided. The continued viability of that case should be re-examined in light of current standards. More recently, in *Metropolitan Life Ins. Co v Ward*, 470 U.S. 869; 84 L. Ed. 2d 751; 105 S. Ct. 1676 (1985), this Court not only used the current rational basis test (470 U.S. at 875), but cast some doubt on whether fostering a domestic industry was a legitimate governmental purpose. It explained that statements to the contrary were based on

commerce clause analysis and that application of equal protection policy would focus on discrimination. (470 U.S. at 876, n.6). Thus, while fostering a particular in-state industry may meet commerce clause analysis, it may not meet the equal protection test.

For present purposes, the classification does not meet the contemporary test and there is jurisprudential value to reconsidering the viability of the case upon which the Department relied below.

B. THE COURT OF APPEALS' DECISION VIOLATES MARCO'S DUE PROCESS RIGHTS.

1. Substantive Due Process Limits Retrospective Judicial Legislation.

The Michigan Court of Appeals has, under the guise of interpreting a 1970 statute, effectively applied a 1987 amendment retroactively. In contrast to all that had been decided before, the Court of Appeals on remand abandoned any trace of a literal interpretation of the 1970 Amendment, which was the very heart of the *Beckman* and First *MARCO* analysis.[8] It relied on the 1987 Amendment which, it

---

[8]The Court of Appeals analysis in the second MARCO decision, while citing Beckman and MARCO is far different than the reasoning of Beckman and the First MARCO case. In Beckman the Court stated:

concluded, was "virtually the same" as the 1970 Amendment to support the Tax Tribunal's requirement of an additional test (a test added to those referenced in the remand instructions). It conveniently did not quote or compare the wording of the statutes in the opinion. The Court's premise that the 1970 and 1987 language is "virtually the same" as to warrant using the 1987 language to decide a 1981-1983 case, is plainly wrong for at least five reasons:

> *First*, the 1987 Amendment (1987 P.A. 141), contains no provision by which the legislature provided that the change was one of clarification only.
>
> *Second*, contrary to the Court of Appeals' claim, the 1970 and 1987 Amendments are not at all similar in their wording:

> "...We presume *that the Legislature intended the meaning that it plainly expressed in this statute. Fraiser v Model Coverall Service*, 182 Mich. App. 741, 744; 453 N.W. 2d 301 (1990). We also presume that a change in a statutory phrase reflects a change in meaning. *In re Childress Trust*, 194 Mich. App. 319, 326; 486 N.W. 2d 141 (1992). Further, if the meaning of the statutory language is clear, then judicial construction of the language is not necessary or permitted. *Lorencz v Ford Motor Co*, 439 Mich. 370, 376, 483 N.W. 2d 844 (1992). When amending the statutory language of section 4(g), the Legislature had the opportunity to follow the Courts' previous definition of "industrial processing" and did not do so, choosing instead to more narrowly define the term. *Beckman, supra*, 344-345. (*emphasis added*)

In the second *MARCO* decision, by contrast, the Court imported words into the 1970 Amendment, which simply are not there.

The 1970 Amendment added a short and simple exception to the exemption as follows:

> "Property sold to a person for use or consumption in industrial processing. Industrial processing *shall not include* tangible personal property permanently affixed and becoming a structural part of real estate; *services performed upon property owned by another where the services do not transform, alter, or modify the property so as to place it in a different form, composition, or character,* office furniture, office supplies, and administrative office equipment; receipt and storage of raw materials purchased or extracted by the user or consumer; vehicles licensed and titled for use on public highways; or the preparation of food and beverages by a retailer for retail sale." MCLA § 205.94(g) (*Emphasis added to show language added in 1970*).

The 1987 Amendment *removed* all the words of the 1970 Amendment and then added a new definition of an "industrial processor" and required (prospectively) that the exemption would require that the property be sold "to an industrial processor for use or consumption in industrial processing". The 1987 Amendment provided in pertinent part:

> "(g) **industrial processing.** Property sold to the following:
>
> (i) *An industrial processor for use or consumption in industrial processing.* Property used or consumed in industrial processing does not include tangible personal property permanently affixed and becoming a structural

> part of real estate; *** office furniture, office supplies, and administrative office equipment, or vehicles licensed and titled for use on public highways. Industrial processing does not include receipt and storage of raw materials purchased or extracted by the user or consumer, or the preparation of food and beverages by a retailer for retail sale. *As used in this subdivision, "industrial processor" means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail. Sales to a person performing a service who does not act as an industrial processor while performing the service may not be excluded under this subdivision, except as provided in subparagraph (ii).*
>
> (ii) *A person, whether or not the person is an industrial processor, when the property is a computer used in..."* (*emphasis added* to show language added in 1987. Asterisks added to show where the 1970 language had been deleted.)

Comparing the 1970 and 1987 versions of the amendment, the entire syntax, wording and structure of the 1987 Amendment was new and different than the 1970 Amendment here at issue. The 1970 language was removed entirely. This Court need only to see the vast differences in

language to conclude that the "virtually same" conclusion was at best wrong on its face.[9]

Third, the reasoning of the Court of Appeals retroactively applied the 1987 Amendment to this case was that, as the Court misread the 1987 Amendment, it required a "sale at retail" test. Even if there were some similarity of language, the very 1987 words which the Court wrongly incorporated through time to 1970 in order to deny MARCO exemption did not exist in the 1970 Amendment.

The effect of the Court of Appeals decision is not only judicial legislation, but also judicial legislation which reaches 17 years from 1987 to 1970. Actually the retroactive judicial legislation reaches back 27 years if one counts from the more relevant 1997 decision date back to the 1970 date of the amendment. A change in substantive tax law can sometimes be made retroactively but there are limits imposed by substantive due process on such retroactive effect. In *McKesson Corp. v Florida Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18,38; 110 S. Ct. 2238, 2252; 110 L. Ed. 2d 17; footnote 23 (1990), this Court, noted that a discriminatory tax law could sometimes be cured by a retroactive change in

---

[9]If the 1987 Amendment were at issue, MARCO would qualify under the 1987 Amendment as well as the 1970 Amendment, but the analysis would be different. In the 1970 Amendment, the property is as applied to MARCO, the engines it tests because it refers to the engines owned by others upon which MARCO provides a service. MARCO must alter those engines. The 1987 language by contrast does not refer to property owned by others. It requires that to be an "industrial processor" one must alter property for sale. MARCO does that. It always has. It alters the engines put into vehicles for sale through the testing process. The long history of the definition of "industrial processing" which is not amended in either Act. So if the 1987 amendment was at issue, and it is not, MARCO would qualify.

the law taxing both classes, but, citing *Welch v Henry*, 305 U.S. 134, 83 L. Ed. 87, 59 S. Ct. 12d (1938), the Court noted that *there would be due process limitations to the number of years back one could reach.* The considerations for retroactive taxation are: (1) could the tax have been anticipated at the time the taxpayer took a voluntary action which was later made a taxable event, (2) could the taxpayer have acted differently if the tax had been anticipated, (3) the Court's note in *McKesson* also suggests that there is some limit on the length of retroactive effect which would be permitted.

Applying those considerations to the present case, the state Court of Appeals in 1997 changed the 1970 act retroactively, 27 years after it was enacted. MARCO took its voluntary actions (entered contracts, committed to prices, etc.) in 1981 to 1983 which is *16 to 14 years before* the state Court of Appeals' decision to abandon the literal meaning of the statutory amendment and to apply 1987 language retroactively. Whether one considers 14, 16 or 27 years as the benchmark, the length of retroactive effect is, to our knowledge, unprecedented and unconscionable.

MARCO could not have foreseen in 1981-1983 that the state would amend its statute in 1987 and then ten years later apply the amendment as a clarification of the 1970 language. MARCO could in those years rely on a long line of precedent, including binding appellate precedent, and an administrative rule, by which its actions before 1970 were exempt and the 1970 amendment, applied literally, would not even arguably change that result because the exception to the exemption itself had an exception as long as MARCO altered the form or character of the engines it tested. It is not just MARCO, which read the 1970 statute as requiring only an alteration of form or character, the Michigan Supreme Court also adopted that interpretation of the statute earlier in this case by adopting Judge Helene White's dissent. To suggest that the judicial "U-turn" that followed the Michigan

Supreme Court's ruling was foreseeable in 1981-1983 is absurd as long as language has meaning. That retroactive change of course increased MARCO's cost dramatically long after its contractual commitments where fixed.

While there are some standards for the limitations on states to impose retrospective law, most such cases arise out of the enactment of new statutory law. MARCO requests that this Court grant certiorari to consider the due process limits on a state's power to create and impose retrospective law through their courts. While the interpretation of state law is left to the states' appellate courts, when a State court retrospectively interprets a statute clearly written to say "tax exempt" to mean "taxable" and does so 27 years after the statute was enacted, there must be a point at which due process is violated. For several reasons we submit this is a reasonable test case because:

1. The pre-1970 state of the law was clear. Based on several binding decisions,[10] MARCO would qualify for exemption.

2. The 1970 Amendment was clear. Applied literally, it created an exception to the exemption, which did not apply if one altered the form, composition, or character of the property.

3. MARCO entered into contracts and set its pricing etc. based on the existing case law concerning the pre-1970 amendment and the 1970 statutory language by which it remained exempt.

---

[10] See note 3, *supra*.

4. The state Supreme Court adopted the dissent of Judge Helene White which had applied the 1970 Amendment *literally* and which adopted a test by which MARCO would prevail.

5. The state Court of Appeals then applied the statute *non-literally* incorporating a 1987 amendment, the language of which was entirely different, as if it were a clarification of the 1970 language.

6. The 1987 Amendment (1987 P.A. 141) was effective in 1987 and the legislation bore no statement of a retrospective intent. (If it had done so, given the clarity of the 1970 language, the difference in language, the reliance interests and the number of years at issue, we would submit that it, too, would violate due process, but the statute contains no such language.)

In one recent such case, *Eastern Enterprises v Apfel*, 524 U.S. ___, 141 L. Ed. 2d 451; 118 S. Ct. 2131, 1998 U.S. (1998), this Court acknowledged retroactively is disfavored in the law. That "fundamental notion of justice" disfavoring retroactive law, the Court explained, has been recognized throughout history both in this Country and in the laws of other nations. The Court recognized that retroactive law is often permitted for "short and limited periods" Lexis at 65. Whether the retroactivity issue is analyzed in terms of Due Process (*Welch v Henry*), the Taking Clause (*Eastern*) or the *Ex Post Facto* Clause (See Justice O'Connor's invitation for reconsideration of whether that clause should be limited to criminal cases, in *Eastern, supra*,), the concept is the same:

> "*Elementary Considerations of fairness dictate that individuals should have an opportunity to know what*

the law is and to confirm their conduct accordingly; settled expectations should not be lightly disrupted".

If state judges insist on "interpreting" state statutes to have a meaning different than the clear language as to effectively judicially amend the statutes, the same "elementary considerations of fairness", which are guaranteed by the U.S. Constitution and, which have been recognized to limit the states when they act through their legislatures, ought to apply to limit the states when they act through their judges.

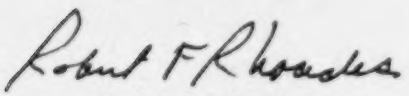
2. The *Sua Sponte* Nature of The Court of Appeals Analysis Violated MARCO's Right to Procedural Due Process.

Concerning procedural *due process*, the *sua sponte* nature of the State Court of Appeals' analysis denied MARCO any opportunity to be heard on the judicially raised assertion that the 1987 Amendment was the same as the 1970 Amendment. MARCO had no notice that anyone would come forth with such an absurd contention. Its opponent had not done so. MARCO had no chance to explain the *differences* in the language and to explain how the entirely different structure of the 1987 language is simply different. By the time the Court ruled, it was too late to brief the points, and further review, though sought, was denied.

VI. CONCLUSION

Because of the importance of a resolution of the questions raised and because compelling arguments exist that the decision of the Court of Appeals below is erroneous, the United States Supreme Court should grant a writ of certiorari and review this case.

Respectfully Submitted,



Robert F. Rhoades, Esquire
MILLER, CANFIELD,
PADDOCK AND STONE
150 West Jefferson,
Suite 2500
Detroit, Michigan 48226
(313) 963-6420

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Order
Entered: August 28, 1998

Michigan Supreme Court
Lansing, Michigan

Conrad L. Mallett, Jr.
Chief Justice

109631 (48)

MICHIGAN AUTOMOTIVE RESEARCH CORPORATION,

Petitioner-Appellant,

v.

James H. Brickley
Michael F. Cavanaugh
Patricia J. Boyle
Elizabeth A. Weaver
Marilyn Kelly
Clifford W. Taylor
Justices
SC: 109631
COA: 184497
MTT: 109067

MICHIGAN DEPARTMENT OF TREASURY,
Respondent-Appellee.

On order of the Court, the motion for reconsideration of this Court's order of May 5, 1998, is considered, and it is DENIED because it does not appear that the order was entered erroneously.

Kelly, J., not participating.

I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

____/s/_____, 19___ /s/ Jacqueline B. MacKinnor___

Order
Entered: May 5, 1998

Michigan Supreme Court
Lansing, Michigan

Conrad L. Mallett, Jr.
Chief Justice

109631

MICHIGAN AUTOMOTIVE RESEARCH CORPORATION,

Petitioner-Appellant,

v

James H. Brickley
Michael F. Cavanaugh
Patricia J. Boyle
Elizabeth A. Weaver
Marilyn Kelly
Clifford W. Taylor
Justices

SC: 109631
COA: 184497

MICHIGAN DEPARTMENT OF TREASURY,
LC: MTT No. 109067

Respondent-Appellee.

On order of the Court, the application for leave to appeal is considered, and it is DENIED, because we are not persuaded that the questions presented should be reviewed by this Court.

Kelly, J., not participating.

I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

____/s/_____, 19___ /s/Corbin R. Davis_____

Court of Appeals, State of Michigan
Order

Michigan Automotive Research Corp v Dept of Treasury

Docket # 184497

L.C. # 00109067

The Court orders that the motion for rehearing is DENIED for lack of merit in the grounds presented.

*Former Court of Appeals judge, sitting on the Court of Appeals by assignment.

A true copy entered and certified by Ella Williams Chief Clerk on

May 09 1997_____ _____/s/Ella Williams_____
Date Chief Clerk

STATE OF MICHIGAN

COURT OF APPEALS

FOR PUBLICATION
March 11, 1997
9:05 a.m.

MICHIGAN AUTOMOTIVE RESEARCH COMPANY,

Petitioner-Appellant,

v

No. 184497
MTT
LC No. 184497

DEPARTMENT OF TREASURY,

Respondent-Appellee.

Before: Hoekstra, P.J., and Marilyn Kelly and J.B. Sullivan,* JJ.

PER CURIUM.

Petitioner appeals as of right a judgment of the Michigan Tax Tribunal (MTT) affirming a use tax assessment, which was made pursuant to an order of remand from our Supreme Court, 447 Mich. 1005 (1994). We affirm.

---

* Former Court of Appeals judge, sitting on the Court of Appeals by assignment.

Petitioner is involved in the testing of engines, powertrains, and transmissions owned by its customers, who manufacture automobiles.' This case began when petitioner was assessed over $44,000 as a use tax for the taxable period March 1, 1981 through December 31, 1983. Petitioner appealed to the MTT, and the MTT ruled that petitioner was involved in industrial processing and was exempt from a use tax under MCL 205.94(g); MSA 7.555(4)(g). The bases for the MTT's ruling were findings that the services were an essential part of the manufacturing process, the engines tested exhibited wear and tear, and the services resulted in the transformation of the engines sold at retail. The MTT did not determine whether the services transformed, altered, or modified the property used so as to place it in a different form, composition, or character in conformity with the test contained in MCL 205.94(g); MSA 7.555(4)(g).

Respondent then appealed the decision of the M11 by right. In an unpublished opinion, *Michigan Automotive Research Corp v Dep't of Treasury*, unpublished opinion per curium of the Court of Appeals, issued 2/14/94 (Docket No. 137368), two judges of this Court reversed the MTT and held that petitioner's services did not qualify for the industrial processing exemption on the basis of the statutory test contained in MCL 205 94(g); MSA 7.555(4)(g). A third judge dissented in part after concluding that the record could have supported a finding that the tested engines were altered to the extent that their form or character was changed. The dissenting judge advocated remanding the case to the MTT for a determination whether petitioner qualified for the exemption on that basis. Petitioner then appealed to our Supreme Court, which remanded the case to the MTT for the reasons stated by the dissenting Court of Appeals judge. On remand, the MTT found that petitioner did not qualify for the industrial processing exemption because it did not transform, alter, or modify the property used as required by the statute. It is from this determination that petitioner now appeals.

The industrial processing exemption to the use tax in effect during the time periods at issue in this appeal read as follows:

The tax levied shall not apply to:

> (g) . . . services performed upon property owned by another where the services do not transform, alter, or modify the property so as to place it in a different form, composition, or character, . . .[MCL 205.94; MSA 7.555(4)].

Thus, the statutory test for determining whether the industrial processing exemption applies is whether the petitioner performs services which transform, alter or modify the property so as to place it in a different form, composition or character. We agree with the MTT that here petitioner was unable to meet this test.

In reviewing decisions of the MTT, this Court is limited to determining whether the tribunal's findings are supported by competent, material, and substantial evidence. *Canterbury Health Care v Dep't of Treasury*, 220 Mich App 23; NW2d (1996). In the absence of fraud, this Court reviews whether the MTT made an error of law or adopted an incorrect legal principle. *Id.* Additionally, petitioner asserts that the MTT incorrectly interpreted the use tax act. Statutory interpretation is a question of law subject to de novo review. *Id.* The primary goal of judicial interpretation of statutes is to ascertain and give effect to the intent of the legislature, *International Business Machines v Dep't of Treasury*, 220 Mich App 83; NW2d (1996), and tax exemption statutes are to be strictly construed in favor of the government, *Beckman Production Services, Inc* v *Dep 't of Treasury*, 202 Mich App 342, 345; 508 NW2d 178 (1993)

Petitioner contends that the MTT made an error of law when it determined that petitioner did not meet the legislative intent of the statutory requirements for the industrial processing exemption. Specifically, petitioner contends that the MTT should have only considered whether its alterations of the property changed the "form, composition, and character" without reference to whether the property was sold at retail. We disagree. Prior to the passage of 1970 PA 15, the industrial processing exemption could be used by persons who provided a service essential to the industrial process of a manufacturer or producer and processed a commodity to

condition it for later sale. *Kress v Dep't of Revenue*, 322 Mich 590; 34 NW2d 501 (1948); *Beckman, supra* at 344. The amendment of §4(g) by 1970 PA 15 more narrowly defined industrial processing to exclude "services performed upon property owned by others where the services do not transform, alter or modify the property so as to place it in a different form, composition or character." *Beckman, supra* at 344.

Section 4(g) was again amended by 1987 PA 141, which rewrote the portion of the act applicable to his case to read ". . . 'industrial processor' means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail...." While it is correct that changes in statutory language are presumed to reflect a change in meaning, *Beckman, supra* at 345, this Court has also recognized that changes in statutory language may reflect an attempt to clarify the meaning of a provision rather than change it. *Ettinger v Lansing*, 215 Mich App 451, 455; 546 NW2d 652 (1996).

We believe that the 1987 amendment to the pertinent portion of §4(g), which contains virtually the same terms as the 1970 amendment with the addition of the phrase ' ultimate sale at retail" evidences a legislative attempt to clarify the meaning of this provision. By incorporating the phrase 'ultimate sale at retail" into this provision, the legislature was reiterating what prior to the 1970 amendment had been accepted as a requirement to qualify for the industrial processing exemption to the use tax.

Accordingly, we find no errors of law on the part of the MTT and conclude that the factual findings are supported by competent, material and substantial evidence. We reject petitioner's contention that the MTT 's consideration of whether an ultimate sale at retail occurred went beyond what was ordered on remand. Remand was ordered so that the MTT could consider whether petitioner qualified for the industrial processing exemption after applying the correct statutory test. Because we believe application of the statutory test included consideration of whether the

property was used in a retail sale, we find petitioner's argument to be without merit.

Affirmed.

/s/ Joel P. Hoekstra

/s/ Marilyn Kelly

/s/Joseph B. Sullivan

[1] The record also indicates that petitioner may have done testing work for oil manufacturers.

Order
Entered: November 1, 1994

Michigan Supreme Court
Lansing, Michigan

99512 & (43)

Michael F. Cavanaugh
Chief Justice

MICHIGAN AUTOMOTIVE RESEARCH CORPORATION,

Petitioner-Appellant,

v

James Levin
James H. Brickley
Patricia J. Boyle
Dorothy Comstock Reiley
Robert P. Griffin
Conrad L. Mallett, Jr.
Justices

SC: 109631
COA: 184497

MICHIGAN DEPARTMENT OF TREASURY,
Respondent-Appellee.

On order of the Court, the motion to participate, as amicus curiae in support of the appellant's application for leave to appeal is considered, and it is GRANTED. The application for leave to appeal is also considered and, pursuant to MCR 7.302(F)(1), in lieu of granting leave to appeal, we MODIFY the judgment of the Court of appeals in the following respect: we REMAND the case the case to the Tax Tribunal for the reasons stated by the dissenting judge in the Court of Appeals.

We do not retain jurisdiction.

I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

STATE OF MICHIGAN

COURT OF APPEALS

MICHIGAN AUTOMOTIVE RESEARCH COMPANY,

February 14, 1994

Petitioner-Appellant,

v

No. 137368

DEPARTMENT OF TREASURY,

LC No. 109067

Respondent-Appellee.

Before: White, P.J., and Cavanaugh and Jansen, JJ.

PER CURIUM

Respondent, Department of Treasury, appeals by right form an order of the Michigan Tax Tribunal canceling an assessment of use tax for the taxable period March 1, 1981, through December 31, 1983, against petitioner, Michigan Automotive Research Corporation (MARCO). We reverse.

The issue on appeal is whether a party which engages in the testing of products owned by its customers, who are auto manufacturers, is entitled to the industrial processing exemption provided for by Section 4(g) of the

Use Tax Act, MCL 205.91 et seq.; MSA 7.555(1) et seq.; and, if not, whether the fact that the exemption is routinely granted to auto manufacturers who test their own products violates equal protection.

The Tax Tribunal concluded that the testing services provided by MARCO to its customers constituted "industrial processing," because the services (a) are an essential part of the manufacturing process; (b) result in wear and tear on the engines tested; and (c) result in the transformation of the production engines that are ultimately sold at retail.

Our review of a decision of the Tax Tribunal is limited to determining whether the decision is authorized by law and is supported by competent, material, and substantial evidence on the whole record. McCormick Foundation v Wawatam Twp (Aft Rem), 196 Mich App 179, 182; 492 NW2d 751 (1992).

The Use Tax imposes a four percent tax upnl the use, storage, or consumption of tangible personal property. MCL 205.93(l); MSA 7.555(3)(1). At the time applicable to this case, property sold to a person for use or consumption in industrial processing was exempted form the tax. MCL 205.94(g); MSA 7.555(4g). "Industrial processing shall not include ...services performed upon property owned by another where the services do not transform, alter, or modify the property so as to place it in a different form, composition, or character...." Id. There is not longer an exception for services that are "absolutely essential" to the industrial process of a manufacturer or producer. Beckman Production Services Inc. v Dept of Treasury, 202 Mich app 342, 345; ___NW2d ___ (1993).

MARCO's testing services did not transform, alter or modify the property tested so as to place it in a different form, composition or character. Wear and tear is not the type of alteration contemplated by the statute. Furthermore, it is irrelevant whether the ultimate product is transformed; the statutory definition clearly refers only to the property upon which services were performed.

Therefore, we conclude that MARCO's testing services were not an industrial process, and the equipment and supplies purchased for use in testing were not exempt from the use tax.

STATE OF MICHIGAN
COURT OF APPEALS

MICHIGAN AUTOMOTIVE RESEARCH COMPANY,

Petitioner-Appellant,

v No. 137368

DEPARTMENT OF TREASURY, LC No. 109067

Respondent-Appellee.

Before: White, P.J., and Cavanaugh and Jansen, JJ.

WHITE, J. (concurring in part, dissenting in part)

I agree with the majority that this Court's decision in Beckman answers the question whether there is a broad exemption for service essential to industrial processing without regard to the statutory language which states that industrial processing shall not include "services performed upon property owned by others where the services do not transform, alter, or modify the property so as to place it in a different form, composition, or character." I believe the been altered to the extent that their form and character have changed. Because the Tax Tribunal, I ruling in plaintiff's favor, did not apply the statutory test, I agree that its decision must be reversed. However, I would remand to the Tax Tribunal for a determination whether plaintiff qualified for the exemption applying the statutory test.

/s/ Helene N. White

STATE OF MICHIGAN
MICHIGAN TAX TRIBUNAL

Michigan Automotive Research Corporation,
Petitioner

v

Department of Treasury,
Respondent

MTT Docket
No. 109067

OPINION AND JUDGMENT

Tribunal Judge Present
Frederick W. Morgan

This matter having come on for hearing before Hearing Officer Claris Kaye Cwirko, and a Proposed Judgment having been issued from which exceptions and written arguments thereto were filed, and

The Tribunal, pursuant to Section 26 of the Tax Tribunal Act, as amended by 1980 PA 437, having considered all matters raised and being fully familiar in the premises, does hereby adopt and incorporate by reference the findings of fact and conclusions of law in the said Proposed Judgment, issued October 30, 1990, as the final decision of the Tribunal.

MICHIGAN TAX TRIBUNAL
By /s/ Fredreck W. Wrogan

Entered: January 15, 1991

STATE OF MICHIGAN
MICHIGAN TAX TRIBUNAL

Michigan Automotive
Research Corporation,
Petitioner

v

Michigan Department of Treasury,
Respondent

MTT Docket
No. 109067

Assessment
No. C566061
Account
No. 38-2185909

Tribunal Judge Present
Frederick W. Morgan

PROPOSED OPINION AND JUDGMENT

Hearing Officer Presiding
Claris Kaye Cwirko

Findings of Fact

This matter, a use tax assessment appeal, was heard at Detroit, Michigan on July 5, 1990. Petitioner appeals assessment number C566061 issued against it for use tax in the amount of $44 J 118, interest computed through May 20, 1987 in the amount of $12,058.31 and a penalty in the amount of $39871 for a total of $60,074.31 none of which has been paid. The taxable period is March 1, 1981 though December 31 J 1983. Prior to the commencement of the hearing the parties filed a partial stipulation of facts. The facts to which they stipulated
are:

1. Petitioner, Michigan Automotive Research Corp. (hereinafter "MARCO"), during the period from 3-1-81 through 12-31-83 performed testing procedures at a facility located at 254 North Main Street, Ann Arbor, Michigan.

2. This matter involves the assessment of use tax by respondent, Department of Treasury, on material purchased by MARCO for use in its testing process as the result of an audit of MARCO.

3. The audit in question was conducted from May 17. 1984, to September 26, 1984.

4. Following the initial contact by the auditor, representatives of MARCO maintained that they were an industrial processor and sought clarification from the Revenue Division that the activities of MAFCO were within the industrial processing exemption.

5. As a result of the audit, the auditor' Mr. Steve Bielak issued an audit transmittal letter on September 26, 1984.

6. MARCO subsequently requested an informal conference which was conducted before Hearing Officer (sic) Mary J. Weseloh on August 8, 19R5. MARCO was represented at the conference by Mr. Gregory DiCenso, and the Department of Treasury was represented by Messrs. Steven Bielak and Anthony Taylor.

7. Following the informal conference, Hearing referee Mary J. Weseloh issued a recommendation on September 24, 1985, to Chief Hearing referee Louis Wirbel concluding that MARCO qualified for the industrial processing exemption and that the proposed assessment in question was improper.

8. The issuance of a Decision and Order- of Determination in connection with intent to assess C566C061 was delayed in part because of expressed concerns of one or more persons outside of the Revenue Division, including taxpayer s' representatives and persons within the Office of the Treasurer of the State of Michigan.

9. A Decision and Order of Determination was ultimately executed on May 20, 1987; and in connection therewith, the Department of Treasury issued final assessment C566C061 and enclosed therewith a copy of the recommendation of Hearing Officer (sic) Mary 3. Weseloh and a statement of rebuttal to her recommendation.

10. The tax: of $44,118 assessed pursuant to Assessment C566C061 represents Michigan Use Tax payable if the purchases in connection therewith are determined to be taxable and not entitled to the so-called "industrial processing" exemption contained in MCL 205.94(g) of the Use Tax Act.

11. If MARCO is determined to be entitled to the industrial processing exemption in connection with the testing activities related to the purchases for which the use tax herein has been assessed, the entire assessment herein shall be cancelled.

12. Materials, supplies, and equipment purchased by auto manufacturers for use in testing procedures have been uniformly granted exemption pursuant to the industrial processing exemption by the Department.

13. Automobile manufacturers are MARCO's principal customers.

14. Automobile manufacturers engage in testing activities substantially identical to those performed by MARCO and are uniformly granted the benefit of the industrial processing

exception with respect to those testing activities by the Department.

15. The penalty of $3, 871.00 included in assessment C566061 represents 25% of the Use Tax determined to be due for that portion of the audit prior to March 1, 1982, when MARCO first registered for sales and use tax. The penalty is assessed pursuant to former MCL 205.24(2) for failure or refusal to file a return or pay a tax within the time specified . . .

The parties also stipulated to the admission of the following exhibits:

Petitioner

1. Audit transmittal letter

2. Letter from hearing referee, Mary J. Weseloh, to Chief Hearing Referee dated September 24, 1985

3. Decision and Order of Determination, Final Assessment, and Statement of Rebuttal dated May 20, 1987

Respondent

1. Audit report
2. Decision and Order of Determination
3. Statement of Rebuttal Assessment C566061
4. Statement of Rebuttal
5. Memo from Sue to Tom
6. Memo from Hoatlin to Sandborn
7. Computer Sheet
8. Notice of Adjustment

Other matters stipulated are not relevant to the disposition of this cause.

Petitioner called two witnesses, Terence John Rhoades, petitioner's vice president, and Thomas Hoatlin, a deputy revenue commissioner.

We accept the facts as stipulated by the parties. After considering the evidence and testimony presented at hearing, we also find that the majority of petitioner's business consists of performing tests on automobile engines and power trains for the three major American automobile manufacturers. Petitioner obtains its contracts through competitive bidding in which petitioner bids against the manufacturers' own in-house testing laboratories.

A substantial portion of petitioner's work consists of a test called a pilot run in which pre-production engines that have been manufactured with production-intent tools are tested by petitioner to assure that the design intent with reference to parts and tooling has been met. Engines identical to those that cannot pass pilot run tests could have failures in the field after automobiles equipped with such engines have been sold to consumers. Such failures could result in recalls at the manufacturer's expense and could also result in injury or death to consumers.

Petitioner also performs product validation testing in which random, representative samples of production engines are subjected to the same tests as those performed during the pilot run. The purpose of this testing procedure is to assure that engines are being built to design specifications and to assure quality control. Production of any engine that cannot pass product validation is halted until the determined defect is corrected.

Petitioner also performs product evaluation testing in which the engine of a specified manufacturer's competitor is purchased, tested and evaluated. This last type of testing is a small part of the total work done for the automobile manufacturers.

The tests performed by petitioner are made pursuant to the manufacturer's published, confidential test procedures. The test protocol is established by the manufacturer who also controls the procedure and supplies the engines that are to be tested. Petitioner, in the course of performing the tests,

purchases fuel, engine parts, electronic parts and other miscellaneous items such as lubricants. The manufacturer is billed for petitioner's cost in an itemized billing. The manufacturer is also billed for the test site running time on an hourly basis. Petitioner collects data as a result of the required tests and publishes that data in the manufacturer's format.

The tests contracted for by the automobile manufacturers are performed at petitioner's Ann Arbor facility. Petitioner's facility is equipped with a number of concrete block test cells where the tests, which are hazardous, are performed. Some engines disintegrate during the tests. Since the engines vary, each test site requires some modification to run a particular test on a particular engine. While petitioner could obtain the necessary parts used during the tests from the manufacturer, it finds it more expedient to purchase those parts directly from the manufacturer's automobile dealers. As an indirect result, the parts available to the ordinary consumers through dealers are also tested by petitioner.

After the testing procedure is completed, petitioner returns the tested engine to the automobile manufacturer together with the parts. The engine that is returned to the manufacturer cannot be installed in an automobile or ultimately sold to a consumer. It is not uncommon for petitioner to make modifications to the engines during testing or to make recommendations to the manufacturer for potential modifications prior to the sale of similar engines to consumers.

Finally, the pilot run and production validation testing are completed several months prior to the commencement of sales of automobiles equipped with similar engines to the ultimate consumers. The purpose of the testing is to identify potential problems or defects prior to actual production runs.

The fuel, engine parts, electronic parts and other items such as lubricants purchased by petitioner are the items respondent has determined are subject to use tax. Petitioner has obtained a sales tax license and has claimed an exemption when purchasing these items. Petitioner does pay sales tax on other supplies it purchases and consumes, such as office supplies.

Conclusions of Law

Section 3 of the Use Tax Act states in pertinent part:

> (1) There is levied upon and there shall be collected from every person in this state a specific tax for the privilege of using, storing, or consuming tangible personal property in this state . . . MCLA 205.93.

Section 4(g), at the times relevant to this appeal, provided that the tax levied by this Act should not apply to:

> Property sold to a person for use or consumption in industrial processing. Industrial processing shall not include tangible personal property permanently affixed and becoming a structural part of real estate; services performed upon property owned by another where the services do not transform, alter, or modify the property so as to place it in a different form, composition, or character, office furniture, office supplies, and administrative office equipment; receipt and storage of raw materials purchased or extracted by the user or consumer; vehicles licensed and titled for use on public highways; or the preparation of food and beverages by a retailer for retail sale. MCLA 205.94(g).

The above amendment to the statute was ordered to take immediate effect on April 20, 1970.

The parties, who presented their closing arguments in writing and filed post-hearing briefs, made much of a 1970 decision of the Michigan Court of Appeals. That decision, in the matter of International Research Development Corporation v Department of Revenue, 25 Mich App 8 (1970) was issued on June 26, 1970, some two months after the amendment to the statute.

The facts of International Research, supra, are that it was a Michigan corporation engaged in the business of testing compounds for its customers who, like petitioner's customers, were manufacturers. International's customers furnished the compounds and International performed the tests in the manner specified by the customer. International then submitted a report to the customer.

In the course of its business, International purchased a quantity of rats and mice that were subsequently used in the testing of compounds pursuant to contract with a customer or customers. International claimed the purchases were exempt from sales and use tax under MCLA 205.94(g). International was not a retailer or wholesaler of any product and had no knowledge of whether the tests it made were ultimately related to products sold at retail to consumers.

The issue presented to the court was whether the research and testing performed by International was a part of industrial processing and, hence, exempt from the use tax assessed against International.

We note that the decision in International, supra, was made under the predecessor statute to the section under consideration here. At the time International, supra, arose, that section of the Use Tax Act stated that the tax levied would not apply to "...(p)roperty sold to persons for use or consumption in industrial processing: Provided, that the term 'industrial processing' shall not be deemed to include tangible personal property permanently a ~fixed and becoming a structural part of real estate."

The Court stated:

> A realistic approach to the issue in this case requires that it be recognized that the manufacturer today must test his products, especially if these products are drugs or other potentially dangerous products. This must be done in order to comply with the Pure Food and Drug Act as well as to protect the manufacturer from possible suit in a product liability case. It is also necessary in order to keep the cost of insurance within reasonable bounds. It would

> seem that the tests that plaintiff is performing are "an essential part of the process of manufacture." International, supra, at 13.

The Court went on to note that the cost of the tests performed by International would be added to the cost which deter-mines the price at which the final product is sold to the ultimate consumer. The Court concluded that "...(s)ince the intent of the exemption is admittedly to avoid pyramiding the use and sales tax, the only way to avoid this result is to recognize plaintiff's claim to the exemption." Ibid.

Petitioner here has relied heavily on this case to support its claimed exemption. Respondent, in turn, has argued that section 4(9) was amended in 1971) specifically to negate the result in this case. Proposed Opinion and Judgment, page 11 MTT Docket No. 109067

Respondent's assertion is clearly erroneous. The amendment to the statute took effect on April 20, 1970. The decision was not rendered until more than two months later. We conclude that the legislature could not have been reacting to a decision that had not been issued.

The other difficulty with this case is that it was decided under a former statute, not the statute before us here. While we do not question the reasoning of the Court of Appeals, we must examine the applicability of this decision when this petitioner is claiming exemption under a subsequent version of section 4(g).

As previously noted, the language of the subsection, at the time pertinent to this appeal, states that industrial processing does not include "...services performed upon property owned by another where the services do not transform, alter, or modify the property so as to place it in a different form, composition or character"

The question then becomes whether the tests performed by petitioner on the engines and power trains of the automobile manufacturers transform, alter or modify those automobile components so as to place them in a different form, composition or character. Stated another way, the question

is whether the results of the tests, which can cause the alteration of the engines and power trains that are finally put into production for placement in automobiles sold to consumers and can, thus, transform the composition of those production engines and power trains, elevate the tests above the statutory "services performed on the property of another" that are not exempt as industrial processing.

There is no doubt, as the International court found, that testing is essential prior to the sale of potentially hazardous products. There can also be no doubt that automobiles and their components are potentially hazardous products or that automobile manufacturers are exposed to the hazards of product liability litigation. Respondent admits that the testing done by the manufacturers in their in-house laboratories is considered industrial processing. No sales or use tax is levied on the automobile manufacturers for the purchase, use and consumption of fuel or parts during the testing process.

Logic dictates that we conclude that the testing performed by petitioner on the engines results not only in wear and tear on the engines tested but also results in the subsequent transformation by the manufacturers of the production engines that are ultimately sold to the consumer.

We have found M E Trucking Company v Michigan Department of Treasury, MTT Docket No. 73927 (decision entered 10/9/85) to be instructive. This decision, while unpublished, was not appealed. While the facts of M E Trucking differ from the facts in this appeal, in that the taxpayer in that case was engaged in waste removal from two plants owned by Ford Motor Company, the conclusions of law offer a concise examination of the state of the law regarding the industrial processing exemption.

As the Tribunal noted:

> ...Industrial processing conceptually connotes the preparation of raw materials for the marketplace. Bav Bottled Gas Co v Department of Revenue, 344 Mich 326; 74 NW2d 37 (1955);

accordingly, the use tax does not apply to tangible personal property in the "processing of commodities to condition the same for- a later sale," Cress v Department of Revenue, 3 ~2 Mich 59 ~}, 593; 34 NW2d 501 (1948). An apparent intent of the Legislature in promulgating the exemption was to preclude the pyramiding of sales and use taxes, International Research Development Corp v Department of Revenue, 25 Mich App 8; 181 NW2d 53; (1970). Under the industrial processing exemption, a person is relieved from the obligation of remitting use tax to the state with respect to items of property which are components of, **or which assist in the composition of,** a finished product to which the sales or use tax ultimately apply. **The availability of the exemption is dependent upon the existence of a post-processing sale. Equipment for which a industrial processing exemption is sought need not be exclusively used in processing...nor does the applicable statutory language require the taxpayer, in the case of multiple uses, to segregate the various uses and remit a proportionate share of tax on non exempt** use, Michigan Allied Dairy Association v State Board of Tax Administration, -302 Mich 643; 5 NW2d 516 (1942). (Footnote omitted.) In ascertaining whether a taxpayer may avail itself of an exemption for industrial processing, primary consideration is accorded to the use to which the equipment is put; the nature of the taxpayer's business is not determinative.

International Research, supra. Further, the class of exemption claimants is not limited to the manufacturer of the completed product. and may embrace a Person engaged in an activity which materially enhances processing undertaken by another. See Kress, supra, where the activity of the taxpayer in supplying water softeners to industrial users was determined to be within the industrial processing exemption; see also, International Research, supra; Minnaert, supra. Finally, one factor found to be significant in the of the equipment or activity will be incorporated within the price charged for the manufactured product, International Research, supra. M E Trucking, supra, 5-7.

As the Tribunal noted in M E Trucking, supra, the fact that a taxpayer's equipment or materials are not located in close proximity to a production line is not relevant to the exemption claim. Indeed, there need be no direct involvement in processing pursuant to the terms of the statute. If MARCO's testing is sufficiently integrated with the automobile manufacturers' manufacturing operations that it exists as a pre-production sequence in a continuous flow of processing of automobile engines and power trains, then this case indicates that the fuel and other items purchased by MARCO and subject to this use tax assessment are exempt.

There can be no doubt that MARCO assists the automobile manufacturers in the processing of automobiles for ultimate sale. While MARCO does not prepare raw materials for the marketplace it does engage in an activity (testing) which materially enhances the processing undertaken by its customers, the automobile manufacturers. In addition, the cost of MAPCO's activity on behalf of the automobile manufacturers is a factor in the price charged for automobiles. MAPCO passes on the cost of fuel, parts and lubricants directly to its clients. We conclude that section 4(9) is applicable and that the testing performed by MARCO is industrial processing. Consequently, the materials, supplies and equipment purchased by MARCO for use in testing automobile engines and power trains for the manufacturers is exempt from use tax.

Petitioner made much of the exemption granted to the in-house laboratories of the automobile manufacturers that perform the same tests done by MARCO. Although our holding in this case negates the necessity of examining that issue, we note that respondent failed to persuade us that there was a rational basis for the classification that results in an exemption granted to automobile manufacturers' in-house laboratories performing identical tests while one is denied to MAPCO.

Other issues raised by the parties in their written closing arguments and briefs, while considered, were not deemed relevant in light of the above conclusions.

JUDGMENT

IT IS HEREBY ORDERED AND ADJUDGED that assessment number C566061 is CANCELLED. IT IS FURTHER ORDERED AND ADJUDGED that the parties to this cause of action shall have 20 days from the date of entry. of this Proposed Judgment to file objections and written arguments with the Tribunal consistent with section 81 of the Administrative Procedures Act [MCLA 24.181; MSA 3.560(181)]. The parties in presenting exceptions and written arguments shall limit them to the evidence and testimony presented to the hearing officer. This Proposed Judgment together with any exceptions and written arguments shall be considered by the Tribunal in arriving at a final decision in this matter pursuant to section 26 of the Tax Tribunal Act [MCLA 205.726; MSA 7.650 (26)].

MICHIGAN TAX TRIBUNAL

By /s/ Claris Kaye Cwirko_____

ENTERED: October 30, 1990

205.94 Use tax; exemptions. [M.S.A. 7.555(4)]

Sec. 4. The tax levied shall not apply to:

* * *

Industrial processing; exclusions.

(g) Property sold to persons for use or consumption in industrial processing. "Industrial processing" shall not include tangible personal property permanently affixed and becoming a structural part of real esate; services performed upon property owned by others where the services do not transform, alter or modify the property so as to place it in a different form, composition or character; office furniture, office supplies and administrative office equipment; receiving and storage of raw materials purchased or extracted by the user or consumer; vehicles licensed and titled for use on public highways; the preparation of food and beverages by a retailer for retail sale. 1970 PA 15

205.94 Exemptions. [MSA 7.555(4)]

Sec. 4. The tax levied shall not apply to:

* * *

Industrial processing.

(g) Property sold to the following:

(i) An industrial processor for use or consumption in industrial process. Property used or consumed in industrial processing does not include tangible personal property permanently affixed and becoming a structural part of real estate; office furniture, office supplies, and administrative office equipment; or vehicles licensed and titled for use on public highways. Industrial processing does not include receipt and storage of raw materials purchased or extracted by the user or consumer, or the preparation of food and beverages by a retailer for retail sale. As used in this subdivision, "industrial processor" means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail. Sales to a person performing a service who does not act as an industrial processor while performing the service may not be excluded under this subdivision, except as provided in subparagraph (ii).

(ii) After December 31, 1984, a person, whether or not the person is an industrial processor, when the property is a computer used in operating industrial processing equipment; equipment used in a computer assisted manufacturing system; equipment used in a computer assisted design or engineering system integral to an industrial process; or a subunit or electronic assembly comprising a component in a computer integrated industrial processing system. 1982 PA 141